Franchise Tax Board

ANALYSIS OF AMENDED BILL

Author:	Chesbro	Analyst:	Marion Mann DeJong	Bill Number:	SB 94
Related Bills:	See Legislative History	Telephone:	845-6979	Amended Date:	05/12/1999
		Attorney:	Patrick Kusiak	Sponsor:	Franchise Tax Board

SUBJECT: Taxpayers' Bill Of Rights Of 1999

SUMMARY OF BILL

This bill would conform, with some modifications, to 25 selected provisions of the Taxpayer Protections and Rights contained in the Internal Revenue Service Restructuring and Reform Act of 1998 (IRS Reform Act).

In addition, this bill would:

- eliminate the tentative minimum tax limitation on personal exemption credits,
- conform to IRS Reform Act technical changes relating to the exclusion of capital gains on the sale of a principal residence,
- delete obsolete refund provisions relating to the renter's credit,
- provide relief to an employee whose employer withheld delinquent taxes from the employee's pay, but failed to remit the amounts to the Franchise Tax Board (FTB), and
- provide FTB administrative authority to compromise a tax debt similar to the IRS's current offers in compromise authority.

See the Table of Contents on page 4 for a complete list of items in the bill.

SUMMARY OF AMENDMENT

The May 12, 1999, amendments added 23 provisions of the Taxpayer Protections and Rights contained in the IRS Reform Act to this bill.

The department's analysis of this bill as amended April 20, 1999, still applies. Analysis of the new provisions is provided below.

EFFECTIVE DATE

As a tax levy, this bill would become effective immediately upon enactment. However, the operative dates of the specific provisions would vary, as discussed in the analysis.

FISCAL IMPACT

For purposes of a high-level, general, discussion of departmental costs, it is initially estimated that for fiscal year 1999-2000 costs would be at least $1,692,500, as follows:

Board Position:			Department Director	Date
X S	NA	NP		
SA	O	NAR		
N	OUA	PENDING	Gerald Goldberg	5/27/1999

- The Legal Branch would need to increase its staff by one tax counsel position beginning fiscal year 1999-2000 at an annual cost of $124,500 to implement Items 9 (Action for Release of Third-party Liens), 15 (Due Process/Collections), 21 (Approval of Jeopardy/Termination Assessments), and 23 (Procedures for Seizure of Property).
- The Audit Division would need to increase its staff by two tax technicians, range B, beginning fiscal year 1999-2000 at a cost of $88,000, with ongoing annual costs of $77,000, to implement Item 11 (Suspension of Interest/Failure to Notify).
- The Communications Services Bureau would need an additional position (associate operations specialist) in Public Affairs and one half of a position plus 800 hours of temporary help (assistant clerk) in the Production Services Section at a cost of $194,000, with ongoing annual costs of $170,000 to implement this bill. The entire bill indirectly impacts the Communications Services Bureau information duties; thus, costs cannot be attributed to individual provisions.
- The Collections Bureau would need to increase staff by three senior compliance representatives, beginning fiscal year 1999-2000 at a cost of $198,000, with ongoing annual costs of $176,000, to implement Item 4 (Innocent Spouse Relief).
- To make the necessary changes to the new personal income tax collection system scheduled for implementation during March 2000 (Accounts Receivable Collection System [ARCS]), FTB would need to increase its staff for fiscal year 1999-2000 by approximately 2.5 personnel years (one associate programmer analyst, one associate information system analyst and one-half senior compliance representative) at a cost of $177,000, with ongoing costs of $147,500 beginning fiscal year 2000-2001 to implement Items 4 (Innocent Spouse), 15 (Due Process/Collections) and 19 (Notice of Contact of Third Parties).
- The business entity taxpayer system (BETS) would need to increase staff by approximately 3.0 personnel years (associate programmer analyst specialist - overtime) and 3.0 personnel years (associate operations specialist - overtime) at a cost of $410,000 for fiscal year 1999-2000 to program and test systems to implement Items 10 (Elimination of Interest Differential), 11 (Procedures for Imposing Penalties) and 27 (Notice to Include Deadlines).
- The taxpayer information system (TI) would need to increase staff by approximately 4.3 personnel years (associate programmer analyst specialist - overtime) and 4.4 personnel years (associate operations specialist - overtime) at a cost ranging from $501,000 to $701,000 for fiscal year 1999-2000 to program and test systems to implement Items 4 (Innocent Spouse Relief), 11 (Suspension of Interest/Failure to Notify) and 27 (Notice to Include Deadlines).

The above costs are **preliminary and could change based on staff's continued analysis of the impact of this legislation on existing operations.**

Tax revenue estimates for each provision are provided in the analysis of that provision. A summary table of the revenue impact is provided on page 3.

Summary of Estimated Revenue Impact

Provision	1999-00	2000-01	2001-02
1. Personal Exemption Credit/AMT	-$1.5	-$1.5	-$1.5
2. Renter's Credit	No Impact		
3. Capital Gain Excl./Personal Residence	No Impact		
4. Innocent Spouse Relief	Minor Losses/-$500,000 annually		
5. Employee Relief/Unremitted Withholdings	Negligible Losses/-$25,000 annually		
6. SOL/Disabled Taxpayers	-$1	-$1	-$1
7. Offers In Compromise	Minimal Revenue Savings/+$40,000 annually		
8. Authority to Award Costs and Fees	No Impact		
9. Action for Release of Third-party Liens	No Impact		
10. Elimination of Interest Differential	-$1.5	-$1.5	-$1.5
11. Suspension of Interest/Fail to Notify	--	-$0.7	-$1
12. Procedures for Imposing Penalties	No Impact		
13. Notice of Interest Charges	No Impact		
14. Abatement of Interest/Disaster Areas	Negligible Loss		
15. Due Process/Collections	Negligible Loss, if any		
16. Financial Status Audits	No Impact		
17. Software Trade Secrets	No Impact		
18. Taxpayer Motion to Quash	Negligible Loss, if any		
19. Notice of Contact of Third Parties	No Impact		
20. Release of Levy on Uncollectible Amts.	No Impact		
21. Approval of JA/TA	Negligible Loss, if any		
22. Waiver of Early-Withdrawal Penalties	Negligible Loss, if any		
23. Procedures for Seizure of Property	No Impact		
24. Proc./Seizure of Residences/Businesses	No Impact		
25. Extension of SOL	No Impact		
26. Installment Agreements	Negligible Gain, if any		
27. Notice Include Deadlines	No Impact		
28. Explanation of Refund Disallowance	No Impact		
29. Whistleblower Disclosure	No Impact		
30. Identification of Return Preparer	No Impact		
Total	**($4.5)**	**($5.2)**	**($5.5)**

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this proposal.

BOARD POSITION

Support.

At its March 23, 1999, meeting, the Franchise Tax Board voted 2-0 to sponsor legislation to conform to the 25 provisions of the Taxpayer Protections and Rights contained in the IRS Reform Act. The Franchise Tax Board voted to sponsor the other provisions of this bill in prior legislative proposals.

TABLE OF CONTENTS

**Analysis of this provision is in the department's analysis of the bill as amended April 20, 1999.

8. Authority to Award Costs and Fees

SUMMARY

This provision (§19717, §21013) would conform to federal changes relating to awarding costs and fees.

EFFECTIVE DATE

This provision would be operative for costs incurred and services performed more than 180 days after the effective date of the bill.

SPECIFIC FINDINGS

Under federal law, reasonable administrative and litigation costs may be awarded to a taxpayer who substantially prevails in an action by or against the United States in connection with the determination, collection, or refund of tax, interest, or penalty. Only an individual whose net worth does not exceed $2 million is eligible for an award. Corporations or partnerships that have net worth not exceeding $7 million are eligible for an award. Awards and denials of attorney fees in administrative proceedings and court proceedings are subject to appeal.

Reasonable administrative costs include: (1) any administrative fees or similar charges imposed by the IRS; and (2) expenses, costs and fees related to attorneys, expert witnesses, and studies or analyses necessary to prepare for the case (to the extent that the costs are incurred before the earlier of the date of the notice of decision by IRS Appeals or the date of the notice of deficiency). Reasonable litigation costs include reasonable fees paid or incurred for the services of attorneys, generally limited to $110 per hour (indexed for inflation). Higher rates may be justified in special situations (e.g., limited availability of qualified attorneys). Attorney fees include fees for services of an individual authorized to practice before the Tax Court or the Internal Revenue Service.

Rule 68 of the Federal Rules of Civil Procedure provides that a party may recover costs if that party's offer for judgment was rejected and the subsequent court judgment was less favorable to the opposing party than the offer. The offering party's costs are limited to the costs (excluding attorneys' fees) incurred after the offer was made.

The federal appellate courts are split over whether a party that substantially prevails over the United States in an action is eligible for an award of reasonable fees and costs. Civil damages may be awarded for the unauthorized inspection or disclosure of return information.

The IRS Reform Act made the following changes to the provisions relating to awarding costs and fees:

- Moved the point in time after which reasonable administrative costs can be awarded to the earliest of (1) the date the taxpayer receives the notice of the decision of the IRS Appeals Division, (2) the date of the notice of deficiency, or (3) the date on which the first letter of proposed deficiency is sent that allows the taxpayer the opportunity for administrative review in the IRS Office of Appeals.

- Raised the hourly rate caps on awards of reasonable attorneys' fees to $125 per hour (indexed for inflation). The difficulty of the issues raised and the unavailability of local tax expertise are among factors that may justify a higher rate. Reasonable attorneys' fees may also be awarded to specified persons who represent, on a pro bono basis or for a nominal fee, taxpayers who are prevailing parties.

- Provided that, in determining whether the position of the United States was substantially justified, the court should take into account whether the government has won or lost in the court of appeals for other circuits on substantially similar issues.

- Provided that an award of fees and costs may be available if, after a taxpayer has a right to administrative review in the IRS Office of Appeals, the taxpayer makes a "qualified offer" that the IRS rejects, and the IRS then obtains a judgment against the taxpayer in an amount that is equal to or less than the taxpayer's offer (without regard to interest). A "qualified offer" is a written offer that is designated as a qualified offer and made by the taxpayer between the date of the first letter of proposed deficiency and 30 days before the date the case is first set for trial.

- Allowed the award of attorneys' fees in actions for civil damages for unauthorized inspection or disclosure of taxpayer returns and return information if the person filing the suit meets the net worth requirements.

Under current state law, taxpayers may appeal adverse FTB actions on protests of deficiency assessments to the BOE. In the event of an adverse determination by the BOE, the taxpayer can pay the amount due and bring an action against FTB in superior court.

Under current state law, taxpayers may be reimbursed for costs/fees and expenses, including attorney fees, relating to tax matters before the BOE or court. For litigation the award may be made to a prevailing party; however, for matters before the BOE, awards may be made if the BOE finds that the Franchise Tax Board has been unreasonable. For both litigation and tax matters before the BOE, fees for representation are limited to attorney fees. For litigation, the allowable amount for attorney's fees is $110 per hour (adjusted for inflation); there is no statutory limit on attorney's fees for BOE hearings. To be entitled to attorney fees for litigation, the taxpayer must exhaust all administrative remedies and prevail before the BOE or in court. At issue in awarding fees for litigation and for BOE hearings is whether FTB can establish that it was substantially justified in its position. FTB's position is presumed not to be substantially justified if the FTB did not follow its applicable published guidance (e.g. regulation, legal ruling, notice, information release, announcement, or any chief counsel ruling or determination letter). Attorney fees awarded in court proceedings are appealable; however, there is no right to appeal matters relating to attorney fees awarded in BOE hearings. Additionally, the taxpayer's ability to receive an award for fees is unaffected by net worth (federal law contains net worth limitations). For litigation, state law (CCP §998) permits a party to receive costs and fees if the party makes a pre-trial settlement offer and the party obtains an equal or more favorable result at trial.

This provision would make the following changes to the law relating to awarding costs and fees:

- Change the starting point after which reasonable costs can be awarded from the date an appeal is filed to the date of the notice of proposed deficiency assessment.
- Raise the hourly rate on attorney's fees for court proceedings from $110 to $125 (BOE hearings would remain unlimited) and add that difficulty of issues and unavailability of local tax expertise would justify a higher rate. (The hourly rate indexing start date would be changed from 1999 to 2001.) Also, permit reasonable attorney fees to persons who represent taxpayers for a nominal fee.
- Provide that when a court is determining whether the position of the FTB was substantially justified, the court can consider whether FTB lost in any California Court of Appeal in another district in a published case involving substantially similar issues.

Policy Considerations

Under current state law, the amount of attorneys' fees that may be awarded are unlimited for cases before the BOE, but are limited to $110 (indexed for inflation) for court. This provision maintains that difference and would raise the amount of attorneys' fees to $125 (indexed for inflation) for court cases.

Implementation

Implementation of this provision would occur during the department's normal annual system update.

FISCAL IMPACT

Departmental Costs

The departmental costs associated with this provision are unknown. Recently, successful fee claims under current law have increased. Since this provision is not funded, the department would be required to redirect costs from another area of its budget.

Tax Revenue Estimate

This provision would not impact state tax revenues unless budget redirection impacted the department's audit or collection programs.

9. Action for Release of Third-Party Liens

SUMMARY

Under this provision (§19226), third parties (e.g., nominees, transferees) whose property is subjected to a lien would be allowed to post a cash deposit or bond equal to the value of the state's interest in that property, as determined by FTB, and obtain a release of the lien. The Taxpayers' Rights Advocate would be required to establish procedures for an independent departmental administrative review of the property value determination, if requested by the third party. The deposit or bond subsequently would be refunded or applied to the tax debtor's account.

EFFECTIVE DATE

This provision would be operative on the effective date of this bill.

SPECIFIC FINDINGS

Under current civil law, for collection purposes, situations may arise where the property of a third party may be subject to levy for another person's debt. An individual may transfer property into a third party's name, but still exercise complete dominion and control over the property. Following investigation of the facts, the third-party may be treated as a "nominee" of the tax debtor for purposes of the specific property and subjected to liens. Also, situations may arise where a third party is secondarily liable for another person's debt based on either law or equity, and the liability is transferred to the third party for purposes of collection (transferee liability). As a transferee, the third party's property is subject to liens in an amount not to exceed the amount of the transferred debt.

Prior to the IRS Reform Act, other than a civil quiet title action, no remedy was available for third parties to obtain a release of an IRS lien. **The IRS Reform Act** allows a third party to obtain a release of the lien by posting a cash deposit or bond equal to the value of the interest the federal government has in the property. A release would enable the owner to sell the property free and clear of the lien. After the release of lien, the third party may bring a civil court action within 120 days to determine the value of the federal government's interest in the property that was subjected to the lien. If no court action is brought, or:

- the court determines the value of the property is less than the value determined by the IRS, the deposit or bond amount is applied to the tax debtor's account;
- the court determines the value of the property exceeds the value determined by the IRS, the difference between the values is refunded to the third party, with interest;
- the IRS determines that the tax debt can be collected from another source;

any deposits are refunded and any bonds released to the third party.

Under California law, other than possibly a civil quiet title action, a third party generally cannot obtain a release of property until the tax debt is satisfied. To claim a refund, the third party could file a claim against the state. In any event, an expedited administrative process is not available for third parties to obtain a lien release.

Under current state law, administrative law judges must conduct most administrative hearings through formal proceedings requiring strict rules of evidence (Administrative Procedures Act [APA]). Expressly excepted from the APA are FTB's protest hearings and hearings regarding jeopardy assessments. Additionally, FTB's informal hearings, which generally relate to collection activities, have not been subject to the APA.

The BOE hears appeals of FTB's actions on deficiency assessments. These hearings involve legal issues regarding the computation of tax before the assessment is final, due and payable and subject to collection actions.

This provision generally would conform to the federal IRS Reform Act provision, except it would require the Taxpayers' Rights Advocate to establish procedures for an independent departmental administrative review (which expressly would not be subject to the formal APA requirements) of the property value determination as a substitute for the court action provided under federal law. The deposit or bond subsequently would be refunded or applied to the tax debtor's account as follows. The taxpayer would be given only 60 days to request a review with respect to the value of the property subject to the lien instead of 120 days allowed under federal law because the federal period appears to be arbitrary and the 60-day period would be consistent with the period allowed for filing a protest of an assessment.

Policy Considerations

The independent departmental administrative review is intended to be a simple, informal process to quickly resolve collection issues, which would not be conducive to the formal process of the Administrative Procedure Act (APA). Therefore, this provision expressly would exempt the review from the APA, as are protest hearings of proposed tax deficiencies, jeopardy assessment and other informal hearings given by the FTB pertaining to collection matters.

Implementation

Staff anticipates this provision could be implemented without significant problems. Collection staff currently responds to third party claims with regard to liens. To accommodate this new process, additional procedures and training would be provided. To the extent third parties were to use this provision, an additional workload to accommodate the administrative review and the processing of the bond or deposit would result, but as previously stated, staff does not anticipant that this provision would be frequently used. Legal Branch could experience a minor additional workload.

FISCAL IMPACT

Departmental Costs

This provision should not significantly increase departmental costs. There could be a minor additional workload for the Legal Branch due to this provision.

Tax Revenue Estimate

This provision would not impact PIT or B&CT revenues.

10. Elimination of Interest Differential

SUMMARY

This provision (§19521) would establish a net interest rate of zero when interest is payable and allowable on equivalent amounts of overpayment and underpayment of income taxes.

EFFECTIVE DATE

This provision would apply to interest for periods beginning after the effective date of the bill. If the applicable SOL has not expired, this provision would also apply to interest for periods beginning before the effective date of the bill if the taxpayer (1) reasonably identifies and establishes the periods of underpayment and overpayment for which the zero net interest rate applies, and (2) on or before December 31, 2000, requests in writing that the FTB apply the zero net interest rate to those periods.

SPECIFIC FINDINGS

Prior to the IRS Reform Act, taxpayers paid higher interest rates on tax underpayments than the IRS paid on tax overpayments. The specific rates were issued quarterly by the IRS, and were calculated as a set number of percentage points above the federal short-term rate:

	Points over Short-Term Rate
Underpayments	3
Overpayments	2
Large corporate underpayments (hot interest)	5
Corporate overpayments > $100,000	0.5

If a taxpayer had an underpayment of tax from one year and an overpayment of tax from a different year that were outstanding at the same time, the IRS typically offset the overpayment against the underpayment and applied the appropriate interest rate to the resulting net underpayment or overpayment. However, if either the underpayment or overpayment had been satisfied, the IRS would not typically offset the two amounts, but rather would assess or credit interest at the underpayment or overpayment rate. This had the effect of assessing the underpayment at the higher underpayment rate and crediting the overpayment at the lower overpayment rate resulting in the taxpayer being assessed a net interest charge even when the amounts of overpayment and underpayment were the same.

The IRS had the authority to credit the amount of any overpayment against any liability under the IRC. Under TBR 2, Congress directed the IRS to implement procedures for “netting” overpayments and underpayments to the extent a portion of tax due was satisfied by a credit of an overpayment.

The IRS Reform Act established a net interest rate of zero on equivalent amounts of overpayment and underpayment that exist for any period. Each overpayment and underpayment is considered only once in determining whether equivalent amounts of overpayment and underpayment exist. The special rules that increase the interest rate paid on large corporate underpayment and decrease the interest rate received on corporate underpayments in excess of $100,000 do not prevent the application of the net zero rate. This global netting is available for any type of tax imposed by the IRC.

Current state law is generally conformed to federal law for the imposition of interest, except that the overpayment rate is the same as the underpayment rate. State law also is conformed to the federal "hot interest" provisions for underpayments in excess of $100,000. If a taxpayer has an underpayment of tax from one year and an overpayment of tax from a different year that are outstanding at the same time, the FTB offsets the overpayment against the underpayment and applies the appropriate interest rate to the resulting net underpayment or overpayment.

This provision would conform to the federal provision to eliminate the interest differential on overlapping periods of interest on tax overpayments and underpayment except the state provision would apply only to income and franchise taxes rather than all taxes. Since the state overpayment and underpayment rates are generally the same this provision would have the most significant impact for corporate taxpayers with "hot interest."

Implementation

This provision would have minor impact on the taxpayer information system (TI) and significant impact on the Business Entity Tax System (BETS) because of "hot interest" imposed on corporate taxpayers. It is unclear how this provision would impact penalty computations that use the interest rate (e.g., estimate penalty).

FISCAL IMPACT

Departmental Costs

The department's costs to administer this provision are preliminary. Department staff will continue to review this provision to determine the costs associated with implementation. A portion of the $410,000 total costs to program and test changes to the BETS system (discussed on page 3 of this analysis) would apply to this provision.

Tax Revenue Estimate

Based on limited data and assumptions discussed below, any forgone interest as a result of this provision is estimated to be on the order of $1.5 million annually.

Tax Revenue Discussion

This estimate is based on the results of FTB's current audit programs, current audit practices and available information on returns filed. The following assumptions were applied:

- It is projected that approximately 65% of PIT audit assessments would be impacted and 80% of B&CT.
- The average period of time for overlapping overpayment and underpayment interest is estimated to be one month under PIT and two and one half months under B&CT.
- On average, overpayments represent approximately 50% of underpayments.
- The average interest rate is estimated to be 9%.

- Adjustments were made under B&CTL to allow for the differential in interest for overpayments and underpayment interest regarding “hot interest”.

11. Suspension of Interest/Failure to Notify

SUMMARY

This provision (§19116) would suspend the accrual of interest and penalties after a specified time unless FTB sends the taxpayer a notice stating the taxpayer’s liability within that time period. Special rules apply for changes based on a change to the federal return.

EFFECTIVE DATE

This provision would apply to taxable years ending after the effective date of the bill.

SPECIFIC FINDINGS

Generally, under **federal law,** the IRS has three years from the later of (1) the original due date of the return (without regard to extensions) or (2) the date on which a return is filed to notify the taxpayer that additional tax is owed. Under **California law,** FTB generally has four years to notify the taxpayer that additional tax is owed. Thus, the state SOL is one year longer than the federal SOL.

Generally, **under federal and state laws**, interest and penalties accrue during periods for which taxes are unpaid, regardless of whether the taxpayer is aware that a tax is due. Generally, **under federal law**, if the taxpayer pays the tax within 21 days of notice and demand for payment of tax, interest is not imposed for that 21-day period. Under **state law**, the 21-day period is replaced with a 15-day period.

Under the IRS Reform Act, the accrual of interest and penalties will be suspended after 18 months unless the IRS sends the taxpayer a notice and demand of payment of tax within 18 months following the later of (1) the original due date of the return (without regard to extensions) or (2) the date on which a timely return is field. For tax years beginning on or after January 1, 2004, the 18-month period will be shortened to one year.

The suspension applies only to individuals who file a timely tax return. The suspension does not apply to the failure to pay penalty, in the case of fraud or with respect to criminal penalties.

Interest and penalties resume 21 days after the IRS sends notice and demand of payment of tax to the taxpayer.

This provision would suspend the accrual of interest and penalties after 18 months unless FTB sends the taxpayer a notice and demand of payment of tax within 18 months following the later of (1) the original due date of the return (regardless of extensions); or (2) the date on which a timely return is filed.

The suspension would apply only to individuals who file a timely tax return. The suspension would not apply to the failure to pay penalty, in the case of fraud or with respect to criminal penalties.

Interest and penalties would resume 15 days after the FTB sends notice and demand for payment of tax to the taxpayer.

Special rules would apply to taxpayers required to report (1) a change or correction by the Commissioner of the IRS or other officer of the United States or other competent authority, or (2) an amended return filed with the Commissioner of the IRS. For these taxpayers, accrual of interest would be suspended as follows:

- If the taxpayer or IRS notifies FTB of the changes within six months of the final federal determination date, interest would be suspended for the period beginning one year from the date the taxpayer or the IRS notifies FTB of the final federal determination, until 15 days after FTB sends notice to the taxpayer.

- If the taxpayer or IRS notifies FTB of the changes after six months from the final federal determination date, interest would be suspended for the period beginning two years from the date the taxpayer or the IRS notifies FTB of the final federal determination, until 15 days after FTB sends notice to the taxpayer.

Thus, FTB would have either one or two years from the date the taxpayer or the IRS notifies the department of the final federal determination to issue a notice before interest is suspended.

Policy Considerations

- This provision would continue the state's policy of providing the taxpayer 15 days to pay upon notice and demand.

- Complex audits such as residency cases and cases with income from flow-through entities take longer to complete than other audits. As a result, it is likely that many complex audits would be completed after the notification period.

- Allowing FTB either one or two years from the date the taxpayer or the IRS notifies the department of the final federal determination to issue a notice before interest is suspended is consistent with the long-standing policy that neither the taxpayer nor FTB should be required to take any action until the federal determination is final.

Implementation

Suspending interest would require a manual process, requiring two additional support positions (Tax Technicians, Range B) in the Audit Branch. System changes would be required to update the tax year on the taxpayer information system (TI) with information for the NPA processing system (PAWS). Audit selection procedures would be reviewed and shortened if possible so audits may begin sooner. Additional support staff, in the case of residency audits, may be required so audits may be completed within the notification period.

FISCAL IMPACT

Departmental Costs

The department's costs to administer this provision are preliminary. Department staff will continue to review this provision to determine the costs associated with implementation. At a minimum, the department's costs to administer this provision would be $88,000 the first year and $77,000 annually thereafter for the manual process to abate the interest. A portion of the total costs for the taxpayer information (TI) systems changes (discussed on page 3 of this analysis) would also apply to this provision. Additional costs may be incurred if, upon implementation, additional audit support staff is required to complete residency audits within the notification period.

Tax Revenue Estimate

Based on the discussion below, any forgone interest as a result of this provision is estimated as follows.

For Taxable Years Ending After Enactment Assumed Enactment After 06/30/1999 Fiscal Year Impact (In Millions)		
2001-02	2002-03	2003-04
($0.7)	($1)	($1.5)

Tax Revenue Discussion

FTB Initiated Notices

This estimate is based on the department's current audit programs, the number of audits and the time in which they are completed. It is estimated that approximately 82,000 taxpayers would be issued notices beyond 18 months from the due date of their return. Assuming a 9% interest rate, the revenue loss is estimated to be approximately $1.5 million annually beginning in fiscal year 2003-04.

Notices Based on a Final Federal Determination

On average the department issues notices, as a result of a final federal determination, within one year from the date the taxpayer or the IRS notifies the department of the final federal determination. Based on discussions with FTB's audit staff, this provision is not anticipated to have a revenue impact, since currently most notices are issued well within the notification period.

12. Procedures for Imposing Penalties

SUMMARY

This provision (§19187) would require notices imposing penalties to include specified information, require FTB to provide the taxpayer with a computation of the penalty upon request, and require management approval of specified penalties.

EFFECTIVE DATE

This provision would apply to notices issued and penalties imposed after December 31, 2001.

SPECIFIC FINDINGS

Under prior federal law, the IRS was not required to show how it computed penalties imposed upon the taxpayer. Further, penalties could be imposed without supervisory approval.

The IRS Reform Act requires the IRS to include on each notice imposing a penalty the name of the penalty, the IRC Section imposing the penalty and a computation of the penalty.

The IRS Reform Act also prevents the imposition of penalties unless the initial determination of the assessment is personally approved, in writing, by the immediate supervisor of the individual making the determination. Supervisory approval is not required prior to an assessment of computer-generated penalties or penalties for failure to file, failure to pay or failure to pay estimated tax.

Under current state practice, notices imposing a penalty include the name of the penalty. In addition, a description of the penalty (including how the penalty is computed in general terms) is provided either by a supplemental form (FTB 1140) or in standardized paragraphs. Some of the standardized paragraphs include the IRC or Revenue and Taxation Code (RTC) section number imposing the penalty. If the taxpayer requests a computation of the penalty, one is provided.

This provision would codify current practice by requiring notices imposing a penalty to include the name of the penalty, the IRC or RTC section imposing the penalty, and a description of the penalty. A computation of the penalty would be provided if requested by the taxpayer.

This provision would also require supervisory approval of all non-computer-generated penalties except failure to file, failure to pay or failure to pay estimated tax penalties. Penalties based upon a federal audit would not require supervisory approval.

Policy Considerations

- Currently, the department provides a description of how penalties are computed and will provide a taxpayer the computation upon request. This provision would continue that practice and not conform to the federal requirement that the penalty computation be provided with every notice imposing a penalty. Providing the computation could cause taxpayer confusion and generate more calls to the department. However, if requests for the computation significantly increase, the department could consider including the computation with every notice at that time.

- Under this provision, penalties based upon a federal audit would not require supervisory approval since the penalties were approved at the federal level.

Implementation

Implementation of this provision would require minor systems changes and procedure changes that would occur during the department's normal annual system update.

FISCAL IMPACT

Departmental Costs

This provision would not significantly impact the department's costs.

Tax Revenue Estimate

This provision would not impact state tax revenues.

13. Notice of Interest Charges

SUMMARY

This provision (§19117) would require every notice sent to an individual that includes interest charges to include a description of the interest computation and the code section imposing the interest. A computation of the interest would be provided if requested by the taxpayer.

EFFECTIVE DATE

This provision would apply to notices issued after December 31, 2001.

SPECIFIC FINDINGS

Under prior federal law, the manner in which the IRS determined the amount of interest charged was not presented to the taxpayer in any notice or other document.

The IRS Reform Act requires every IRS notice sent to an individual that includes interest charges to include a detailed computation of the interest charged and the IRC section imposing the interest.

Under current state practice, a supplemental form (FTB 1140) is enclosed with notices. FTB 1140 provides a description of various penalties, how interest is charged (including the applicable interest rates), collection costs, taxpayer rights and how to contact the Taxpayer's Advocate. If the taxpayer requests a detailed computation of the interest, one is provided.

This provision would codify current practice by requiring a description of the interest computation and the code section imposing the interest to be included with notices sent to individuals. A detailed computation of the interest would be provided if requested by the taxpayer.

Policy Considerations

Currently, the department provides a description of how interest is computed and will provide a taxpayer the computation upon request. This provision would continue that practice and not conform to the federal requirement that the interest computation be provided with every notice. Providing the computation with every notice could cause taxpayer confusion and generate more calls to the department. However, if requests for the computation significantly increase, the department could consider including the computation with every notice at that time.

Implementation

This provision would codify current practice.

FISCAL IMPACT

Departmental Costs

This provision would not significantly impact the department's costs.

Tax Revenue Estimate

This provision would not impact state revenues.

14. Abatement of Interest/Disaster Areas

SUMMARY

This provision (§19109) would require FTB to abate interest that would otherwise accrue if the FTB extends the due date for filing income tax returns and for paying income tax for any individual who incurred a disaster loss and is located in a Presidentially declared disaster area or an area declared by the governor to be in a state of disaster.

EFFECTIVE DATE

This provision would apply to disasters declared after December 31, 1997, with respect to taxable years beginning after December 31, 1997.

SPECIFIC FINDINGS

Under prior federal law, in the case of a Presidentially-declared disaster, the IRS had the authority to postpone some tax-related deadlines, but had no authority to abate interest.

Under the Taxpayer Relief Act of 1997, the IRS is required to abate interest for the same period for which the IRS has provided an extension of time to file tax returns and pay taxes (and waives any penalty) for individuals located in Presidentially-declared disaster areas that are declared disasters during 1997.

The IRS Reform Act removed the restriction that made the abatement apply only to areas declared a disaster during 1997 and expanded the provision to all taxpayers. Thus, the IRS is required to abate interest for the same period of time for which the IRS has provided an extension of time to file tax returns and pay taxes (and waives any penalty) for taxpayers located in Presidentially-declared disaster areas declared a disaster after December 31, 1997.

Current state law conforms to the provisions of the Taxpayer Relief Act of 1997. FTB is required to abate interest for individual taxpayers located in a Presidentially-declared disaster area for the period the FTB extended the time to file a return and pay the tax (and waive any penalty) for disasters declared during 1997.

Under current state law, FTB has authority to grant PIT taxpayers an extension for payment of tax when good cause exists. Unlike the IRS, FTB does not have this authority for B&CT taxpayers.

This provision would remove the restriction that makes the abatement apply only to areas declared a disaster during 1997 and would require the taxpayer to sustain a loss in the disaster. In addition, the interest abatement would be extended to areas declared by the governor to be in a state of disaster. Thus, FTB would be required to abate interest for individual taxpayers who incur a disaster loss and are located in a Presidentially-declared disaster area, or an area in this state declared by the governor to be in a state of disaster, for the period the FTB extends the time to file a return and pay the tax.

Policy Considerations

- Unlike the IRS Reform Act, this provision would not apply to corporations since FTB does not currently have the authority to grant corporations an extension for payment of tax when good cause exists.
- Unlike the IRS Reform Act, this provision would require the taxpayer to sustain a disaster loss in addition to being located in a disaster area. This change was made in response to widespread criticism of the federal change which extended the benefit to everyone within a county in which a disaster occurred, even if they personally suffered no ill effects.
- Expanding the federal provision to include areas in this state declared by the governor to be in a state of disaster would provide relief to additional taxpayers that have suffered losses.
- This provision would apply to individuals located in a Presidentially-declared disaster area that is located outside of California but would not apply to individuals located in another state declared by that state’s governor to be in a state of disaster.

Implementation

Implementation of this provision would occur during the department’s normal annual system update.

FISCAL IMPACT

Departmental Costs

This provision would not significantly impact the department's costs.

Tax Revenue Estimate

Any forgone interest would depend on the extent to which interest would not have otherwise been abated under current law. To the extent FTB abates additional interest as a result of this provision, the amount of interest assessed would be reduced. However, due to the deductibility of disaster losses, it is estimated that the majority of taxpayers located in disaster areas would not have a balance due return. Therefore, any forgone interest would be negligible.

15. Due Process/Collections

SUMMARY

This provision (§19227, §21015.7) would require FTB to notify tax debtors:

- within five business days that a notice of lien has been filed. During the 30-day period following notification, tax debtors may request an independent departmental administrative review.

- at least 30 days before it intends to levy. The notice would have to include the proposed actions that may be taken (but does not require itemizing the property) and the laws and procedures relating to the release of levy. The notice would have to be given by first class mail to the address of record, unless mail to the same address was returned undelivered with no forwarding address, in which case notice would not be required. No levies may be made during the 30-day period. If the tax debtor were to request a departmental independent administrative review, collection action must be suspended during the review period plus 15 days. The provisions would not apply to jeopardy assessments, but FTB would be required to give these tax debtors an opportunity for hearing within a reasonable time.

Issues subject to review for liens and levies would include spousal defenses or collection alternatives. In conducting the review, consideration would be given as to whether the collection action balances the need for collection of the debt with the legitimate concern that any collection action be no more intrusive than necessary. The independent departmental administrative review would not be subject to the formal Administrative Procedures Act (APA) requirements.

EFFECTIVE DATE

This provision would be operative for collection actions initiated more than 180 days after the effective date of the bill.

SPECIFIC FINDINGS

Under the IRS Reform Act, the IRS is required to notify tax debtors by notice given in person, left at their dwelling or business or by mail when a notice of lien has been filed or it intends to levy. In the case of a notice by mail, the notice must be registered or certified mail, return receipt requested. The notice of the filed lien must be mailed within five business days after the filing of the lien and the notice of intent to levy at least 30 days before making a levy. The notice of intent to levy must include the proposed action(s), but does not require itemizing the property. The notification must include information regarding the redemption of property and releasing of liens. During the period following notification, tax debtors may request a hearing before an appeals officer with no prior involvement in the case. Issues may include spousal defenses and collection alternatives, and the tax debtor may challenge the underlying tax liability if the tax debtor did not receive statutory notice of deficiency or did not have an opportunity to dispute the tax liability. Tax debtors may seek judicial review of the hearing officer's findings. If a hearing or appeal is timely requested, levy action must be suspended until 90 days following a final determination, unless the court otherwise allows levy. These provisions do not apply to state tax offset procedures and jeopardy or termination assessments, but these tax debtors shall be given an opportunity for hearing within reasonable time.

Under current state law, if FTB determines there is a tax deficiency, it mails a notice of proposed assessment (NPA), and the taxpayer has 60 days to protest the assessment or it becomes final. Once the assessment is final, the taxpayer is mailed a statement of tax due. If the taxpayer disagrees with the amount of the final assessment, the assessment must be paid and a claim for refund filed, unless it is obvious that the assessment is in error in which case the assessment may be abated without payment. **Under FTB's current practice**, if the account remains unpaid, the tax debtor generally receives several collection notices. The notices are mailed first class to the address of record, unless mail to the same address was previously returned. FTB is required to mail notice of intent to file a lien at least 30 days before the lien is filed (RTC §21019). According to the Civil Code (Section §2885), a notice of state tax lien must be mailed to the tax debtor unless mail to that address was previously returned undeliverable with no forwarding address.

During 1996, FTB filed through its automated system approximately 300,000 liens on tax debts in excess of $250. However, recently FTB has increased from $250 to $1,000 the amount of tax debt that would be subjected to a lien filed through its automated system. This increase in the tax amount is expected to decrease the filing of liens by approximately 35%.

Under FTB's current practice, a statement of tax due (STD) is mailed as a first notice with respect to all debts. The STD is drafted in a taxpayer-friendly, non-threatening manner. If the debt remains unpaid, FTB generally will mail a notice stating that unless payment is made collection action may be taken (involuntary collection billing cycle) and provides a general statement as to the type of collection actions that FTB may take. However, when a debt posts to an account on which there is an existing debt that has entered the involuntary collection billing cycle, an STD is the only notice mailed on the new debt. The debts are then consolidated and the involuntary collection billing cycle continues, which may include levies.

After a levy attaches to bank accounts or other cash equivalent property, or an employer receives a wage levy, the tax debtor is given at least 10 days to resolve the matter before the amounts levied are remitted to FTB. In the event property is to be sold, the debtor is provided a special hearing in accordance with case law at least 20 days before property may be sold and the funds remitted to FTB. While tax debtors have no formal process for appealing collection actions, they may contact the Taxpayers' Rights Advocate if staff cannot resolve the collection issue. During this period of conflict, collection is stayed only at the discretion of staff.

Under California law, only real property sold under foreclosure pursuant to a mortgage or deed of trust is subject to redemption by the debtor (Code of Civil Procedure [CCP] 729.010 et seq.). Sales of property to satisfy any other debt, including tax debts, are not subject to redemption.

Under this provision, FTB would adopt provisions similar to the federal provisions except:

- For notification that a lien is filed or intent to levy, notice would be made only by first class mail and would include information about release of levy, but this provision would not require FTB to provide information on its notices regarding redemption of property or releasing liens. Notice would not be required only if mail to the same address was returned undeliverable with no forwarding address.
- For notice before a levy, notice would not be required if the debt to which the levy is made were consolidated with a debt for which collection actions may be commenced.
- The tax debtor's issues with respect to the filing of the lien or intent to levy would be subject to an independent departmental administrative review instead of an appeals officer. The review would not be subject to California's formal APA requirements.
- The issues subject to review for either the filing of the lien or intent to levy could not include challenging the underlying tax, and the findings of the review would be final and not subject to appeal.
- The suspension from levying would be for 15 days following the review determination instead of 90 days as allowed by the IRS.

Policy Considerations

Current procedures for mailing FTB lien notices are governed by general Civil Code sections that apply to all state agencies. Requiring first class mail for lien notification to conform to the federal provision would place FTB out of conformity with all other state agencies and have a major impact on departmental costs.

Implementation

This provision could be implemented without significant procedural, workload or system changes. It is anticipated that the first notice FTB issues on tax debts would not be affected by this provision. The notice prior to levy would be accomplished by one or more of the notices that FTB anticipates would be issued via FTB's new collection system currently under design. The Taxpayers' Rights Advocate would have to establish an independent departmental administrative review process, in the event a request for review may be made.

However, if FTB were required to send a notice before levy on debts prior to consolidation with existing debts, FTB would either have to change its: (1)

current first notice issued to taxpayers (statement of tax due) to include the pre-levy statement, which would make for a more threatening, less taxpayer-friendly notice that could reduce compliance, or (2) billing structure to allow for a pre-levy notice prior to consolidation of debts and continuation of the involuntary collection billing cycle, which would create programming difficulties and potentially increase department costs. In addition, if a debt has entered the involuntary collection billing cycle at the time a new debt posts, it is doubtful that sending an additional notice on the new debt would result in compliance or otherwise benefit the tax debtor in a manner that would warrant either a change in the STD or billing structure.

FISCAL IMPACT

Departmental Costs

This provision should not significantly increase departmental costs. However, to the extent requests for administrative review are made under this provision that otherwise would not have been resolved by FTB staff under an existing workload, there would be costs for that additional workload. In addition, to the extent strategies or the design of the Accounts Receivable Collection System, which is scheduled for implementation during March of 2000, must be reformulated, costs budgeted for this system could be exceeded. There could be a minor additional workload for the Legal Branch due to this provision.

Tax Revenue Estimate

Collection losses from this provision would result in negligible revenue losses if any (less than $250,000 annually based on federal projections).

16. Financial Status Audits

SUMMARY

This provision (§19504) would prohibit FTB, when examining a return, from using financial status or economic reality examination techniques to determine unreported income unless FTB has reasonable indication of unreported income.

EFFECTIVE DATE

This provision would apply to examinations beginning on or after the effective date of the bill.

SPECIFIC FINDINGS

Prior to the IRS Reform Act, whenever an IRS agent encountered a low stated gross income on a personal tax return for a taxpayer obviously living well, the agent could ask assorted “financial status questions” to determine if there was any unreported income. While a traditional IRS audit principally focuses on books, records and other audit evidence directly related to the tax return and its preparation, financial status auditing (formerly known as economic reality audit) focused on unreported income at the very beginning of the audit. These financial status questions focused on the taxpayer's lifestyle, standard of living, and other elements unrelated to the specific preparation of the tax return.

Under the IRS Reform Act, the IRS is prohibited from using financial status or economic reality examination techniques to determine the existence of unreported income of any taxpayer unless the IRS already has a reasonable indication that there is a likelihood of such unreported income.

Current FTB audit practice does not include financial status or economic reality examination techniques unless there is a reasonable indication of unreported income. However, these techniques may be used in criminal investigation cases where there is a reasonable indication of unreported income.

Currently, the FTB Filing Enforcement Program estimates income based upon third-party information to evaluate whether a taxpayer has an unsatisfied filing requirement. If the taxpayer does not respond, an assessment is made based upon the information available. If, at any point, the taxpayer files a return, provides information that he or she has no filing requirement or provides proof that they already filed, the filing enforcement activity is stopped.

This provision would codify current practice by prohibiting FTB, when examining a return, from using financial status or economic reality examination techniques to determine unreported income. However, these techniques may be used if FTB has reasonable indication of unreported income.

Policy Considerations

The federal law does not specify whether these techniques are prohibited only when a taxpayer files a return. However, the committee reports and explanations of the federal provision discuss only the examination of a return filed by the taxpayer. The department's Filing Enforcement Program uses methods similar to financial status and economic reality test when determining whether a taxpayer has a filing requirement. This provision would specify that the prohibition applies when examining a tax return filed by the taxpayer.

Implementation

This provision would codify current practice.

FISCAL IMPACT

Departmental Costs

This provision would not impact the department's costs.

Tax Revenue Estimate

This provision would not impact state tax revenues.

17. Software Trade Secrets

SUMMARY

This provision (§19504.5) would prohibit FTB from issuing a subpoena in a civil action for any portion of computer source code unless certain requirements are satisfied. Computer source software or source code information would be included in disclosure protections.

This provision (§19542.3) also would make it either a misdemeanor or a felony, punishable by up to $5,000 fine or imprisonment of not more than five years, or both, to willfully divulge or make known software obtained by subpoena to any person.

EFFECTIVE DATE

This provision would be operative for subpoenas issued and software acquired after the effective date of the bill. The disclosure rules would apply 90 days after the effective date of the bill to software and source code acquired on or before the effective date of the bill.

SPECIFIC FINDINGS

Under current federal law, the IRS is authorized to examine books, papers, records or other data that may be relevant to an inquiry into the correctness of a federal tax return. In addition, the IRS may issue and serve a summons on certain third-party recordkeepers.

The IRS has been criticized for abusing its summons power in recent audits by obtaining the software source code of programs used to produce an audited tax return. According to the critics, the intellectual property rights of developers and owners should be respected. They claim that the examination of computer source code could lead to the inadvertent disclosure of trade secrets.

The IRS Reform Act generally prohibits the IRS from issuing a summons or enforcing a summons to produce or analyze any tax-related computer software and source code that is obtained by the IRS in the course of the examination of a taxpayer's return. However, a summons may be issued for tax-related computer source code if:

1. the IRS cannot otherwise reasonably ascertain the accuracy of any item on a return from the taxpayer's records, or computer software program and related data which, when executed, produce the output to prepare the return;
2. the IRS identifies with reasonable specificity the portion, item, or component of the source code needed to verify the correctness of a return item;
3. the IRS determines that the need for the source code outweighs the risk of an unauthorized disclosure of trade secrets.

The IRS will be treated as satisfying the first two conditions if it (1) concludes it is not feasible to determine the correctness of a return item without access to the computer software executable code and associated data; and (2) formally asks both the taxpayer and the software owner for the code and the code is not provided within 180 days.

The limitation on the summons of tax-related computer software source code will not apply:

1. if the summons is issued in connection with an inquiry into any offense connected with the administration or enforcement of the IRC;
2. to a summons of any tax-related computer software source code that was acquired or developed by the taxpayer or a related person primarily for internal use, rather than for commercial distribution, by the taxpayer or related person;
3. to communications between the owner of the tax-related computer software source code and the taxpayer or related persons; or
4. to any tax-related computer software source code that is required to be provided or made available under any other provision of the IRC.

Any person summoned may contest the action in any proceeding to enforce the summons. The court must, at the request of any party, hold an evidentiary hearing to determine whether the summons requirements have been met. Moreover, any court enforcing a summons may issue any order necessary to prevent disclosure of confidential information.

In addition to authorizing district courts to issue protective orders, other specific safeguards are in place to ensure protection against improper disclosure by the IRS of trade secrets and other confidential information. These safeguards include the following.

1. Computer software or source code may be examined only in connection with the examination of a taxpayer's return with which it was received.
2. The IRS must provide the taxpayer and the software owner with a written list of the names of all persons who will analyze or otherwise have access to the software.
3. The software must be maintained in a secure area.
4. The computer source code may not be removed from the owner's place of business without the owner's consent, unless a court orders removal.
5. The software many not be decompiled or disassembled.
6. The software or source code may be copied only as necessary to perform the specific examination and the IRS must number all copies and provide written certification that no other copies have or will be made. At the conclusion of the examination and related court proceedings, the copies must be accounted for and returned to the owner and permanently deleted from any hard drives.
7. If an individual who is not an officer or employee of the United States examines the software, the individual must enter into a written agreement with the IRS that the individual (a) will not disclose the software to anyone other than IRS authorized agents and employees and (b) will not participate, for two years, in the development of software that is intended for a similar purpose.
8. Computer software or source code that is obtained by the IRS in the course of the examination of a taxpayer's return will be treated as return information for disclosure purposes.

Any person who willfully divulges or makes known to another person software that was obtained for the purpose of examining a taxpayer's return will be punished, upon conviction, either by imprisonment not to exceed five years or by a fine not to exceed $5,000, or by both.

The IRS Reform Act provides definitions for "software," "tax-related computer software source code," "computer software executable code," and "related person."

Under current state law, FTB is authorized to examine books, papers, records or other data that may be relevant to an inquiry into the correctness of a state tax return. In addition, the FTB may issue subpoenas on certain third-party record keepers.

This provision would conform to the provisions of the IRS Reform Act relating to software trade secrets. Generally, FTB would be prohibited from issuing a subpoena in a civil action for any portion of any third-party tax-related computer source code unless specified requirements are satisfied. Specific protections would be provided for disclosure and improper use of trade secrets and other confidential information related to computer programs and source code in the possession of the FTB as a result of an examination of any taxpayer. Computer source software or source code information would be included in the disclosure protections. The federal law would be modified to specify that this provision would not apply to software acquired or developed for internal use by FTB.

This provision also would make it either a misdemeanor or a felony, at the court's discretion, to willfully divulge or make known software obtained by subpoena to any person. If convicted, the offense is punishable by up to $5,000 fine or imprisonment in the county jail not to exceed one year, or in state prison not to exceed five years, or both.

Policy Considerations

- The IRS Reform Act added an owner or developer of a computer software source code to the definition of third-party record keepers for purposes of summonses. California law does not contain a definition of third-party record keepers; it provides rules for any party subpoenaed.

- The IRS Reform Act made it a felony to willfully disclose software. This provision would make it a misdemeanor or a felony at the discretion of the court in light of California's "Three-Strikes" law. This modification from the federal provision is consistent with other recently enacted "wobbler" penalties.

Implementation

Implementation of this provision would occur during the department's normal annual system update.

FISCAL IMPACT

Departmental Costs

This provision would not significantly impact the department's costs.

Tax Revenue Estimate

This provision would not impact state tax revenues.

18. Taxpayer Motion to Quash

SUMMARY

Under this provision (§19064), in the absence of resolution of any subpoenaed person’s (rather than only a third-party record keeper’s) response to a subpoena (motion to quash), the statute of limitations (SOL) for making assessments would be suspended for the person whose liability is related to the subpoena.

EFFECTIVE DATE

This provision would be operative for subpoenas served after the effective date of the bill.

SPECIFIC FINDINGS

Before the IRS Reform Act, **under federal law** if IRS summons a third-party record keeper, the taxpayer could file a motion to quash, and the SOL for assessment and collection was suspended for the person whose liability is related to the summons.

Under the IRS Reform Act, the suspension of the SOL for assessment and collection applies to any person summoned not only third-party record keepers. This provision is operative for summons served after enactment.

State law generally conforms to the above federal provision. FTB may issue subpoenas to any person (third parties, including record keepers) to obtain taxpayer information. If the FTB serves a subpoena on a third-party recordkeeper, as defined by federal law as of January 1, 1993, and resolution to a response to a subpoena (motion to quash) is not forthcoming, certain SOLs relating to making assessments are suspended for a specified time, with respect to the person whose liability is related to the subpoena.

Under this provision, California would conform to the IRS Reform Act provisions. If FTB subpoenas any person (not only third-party record keepers) and resolution is not forthcoming, certain SOLs relating to assessment would be suspended, with respect to the person whose liability is related to the subpoena.

Implementation

This provision could be implemented without significant problems for the department.

FISCAL IMPACT

Departmental Costs

This provision would not affect the department’s costs or state tax revenue.

Tax Revenue Estimate

Based on the negligible revenue loss projected for the federal provision relating to motion to quash, revenue losses from conforming to the federal provision would be negligible, if any.

19. Notice of Contact of Third Parties

SUMMARY

This provision (§19504.7) would require FTB to issue a notice to taxpayers before contacting third parties with respect to determinations or collection of tax liability. The notice would apply to contacts made during the 12 months following the notice. If contacts are to be made after that 12-month period, another notice must be issued prior to the later contacts. Record of contacts would be provided upon taxpayer request made within 60 days following the 12-month period. Notification does not apply to contacts authorized by the taxpayer, where notice would jeopardize collection of tax, result in reprisal, or for criminal investigations.

EFFECTIVE DATE

This provision would be operative for contacts made 180 days after the effective date of the bill.

SPECIFIC FINDINGS

Under the IRS Reform Act, IRS is required to notify a taxpayer before contacting third parties with respect to the determination or collection of the taxpayer's tax liability. IRS must periodically provide taxpayers a record of persons contacted and also provide the record upon request by the taxpayer. Notification does not apply to contact authorized by the taxpayer, where notice would jeopardize collection of tax, result in reprisal or for criminal investigations.

Currently, during an audit, FTB issues notice to taxpayers prior to contacting third parties, unless notice would raise confidentiality issues or the audit is part of a criminal investigation. In FTB's filing enforcement process (where a tax return has not been filed for that year, and FTB determines whether there is a requirement for a person to file a tax return for a particular year and what tax amount FTB would propose to be assessed for that year), FTB typically uses information provided via information returns or other information sources. However, when FTB is determining whether to open an audit or on occasion during the filing enforcement process, FTB contacts third parties to obtain or clarify information, in which case notice prior to the contact currently is not given to the tax debtor. In addition, in making a determination whether an individual is a resident subject to California tax and as to what tax amount FTB would propose to be assessed (residency audits), FTB may contact governmental agencies and businesses in and out of state without giving the taxpayer prior notice. Also, in the process of collecting tax debts, FTB does not notify tax debtors that third parties may be contacted.

Once a tax amount is final, whether assessed by FTB or self-assessed, and unpaid, a statement of tax due (STD) is mailed as a first notice. If the debt continues to remain unpaid, FTB generally will mail a notice that unless payment is made collection action may be taken (involuntary collection billing cycle) and provides a general statement as to the type of collection actions that FTB may take. Notice will not be mailed, if prior notice mailed to the address of record is returned undeliverable with no forwarding address. When a debt posts to an account on which there is an existing debt that has entered the involuntary collection billing cycle, an STD is the only notice mailed on the new debt. The debts are then consolidated and the involuntary collection billing cycle continues, which may include levies. In no event, does FTB disclose the identity of third parties to taxpayers or send taxpayers a record of persons contacted.

Under this provision, FTB would conform to the IRS Reform Act provision by requiring FTB to issue notice to taxpayers before contacting third parties with respect to determinations or collection of tax liability, which could include filing enforcement. Notification would not be required when contact is authorized by the taxpayer, or where notice would jeopardize collection of tax, where notice may result in reprisal, or for criminal investigations. However, detail as to the notification and disclosure requirements would differ:

- Notice would not be required if the debt for which the notice would otherwise be made is consolidated with a debt for which notice has been given and collection actions may have commenced.
- Notification would be in effect for contacts made during the 12 months following notice. If contacts are to be made after that period, another notice would be issued.
- Record of persons contacted would not be periodically provided, but instead would be provided only upon taxpayer request made within 60 days following the 12-month period; and
- FTB’s notice preliminary to the third-party contacts would have to explain that such requests may be made.

Policy Considerations

While in some cases FTB's current filing enforcement or audit practice does provide notification that FTB may be questioning third-parties, a person’s privacy may be unduly invaded in cases where FTB’s current practice does not require such notification. It may be argued that a person has a right and need to know that FTB is going to make these contacts and that FTB contacts could be detrimental to that person’s reputation and/or an embarrassment. Therefore, prior notice of all such contacts is appropriate.

Implementation

This analysis assumes that a third party (“person” other than the taxpayer) would not include contacting governmental agencies and this provision would not apply with respect to contacts that FTB may make to clarify data furnished to FTB via information returns or clarify data it receives from information sources (e.g., county records, Department of Consumer Affairs, IRS or Employment Development Department).

However, as it would apply, this provision could delay the issuance of certain filing enforcement assessments, the opening of certain audits or conclusion of residency audits. During these processes, if FTB anticipates contacting third-parties that are other than governmental agencies, the taxpayer would have to be given notice prior to the contact. For collection purposes, FTB’s notice issued before an account enters the involuntary collection billing cycle would need to be changed to include the required notification. Implementation presumes that for audits, filing enforcement and accounts referred for manual collection, the third-party-contact information would be entered manually onto the account, and the disclosure of the third-party-contact information would be processed manually. The design of and/or strategies affecting the Accounts Receivable Collection System, which is scheduled for implementation during March of 2000, would require change to retain the third-party contact information.

FISCAL IMPACT

Departmental Costs

This provision should not significantly increase departmental costs. However, to the extent the third-party-contact information must be manually entered onto the tax debtor's account, there would be additional time attributable to doing the work. Additionally, to the extent strategies or design of the Accounts Receivable Collection System, which is scheduled for implementation during March of 2000, must be reformulated, the costs budgeted for this system could be exceeded.

Tax Revenue Estimate

This provision should not significantly impact state revenues.

20. Release of Levy on Uncollectible Amounts

SUMMARY

This provision (§21016) would require FTB to immediately release a wage levy if the tax is not collectible, because it is no longer due and payable.

EFFECTIVE DATE

This bill would be operative for earnings subject to levy on or after the effective date of the bill. Because this provision codifies FTB's current practice and potentially affects a person's wages, this provision would be operative on the effective date of the bill rather than contain a delayed operative date as provided under the federal provision.

SPECIFIC FINDINGS

The IRS Reform Act requires IRS to immediately release a wage levy upon agreement with the taxpayer that the tax is not collectible. According to the Conference Report, this provision was enacted because complaints had been received that IRS delays releasing a wage levy that is uncollectible until one period's wage payments are levied.

Currently, once a tax debt is satisfied (through payment, abatement or other adjustments), FTB's automated system routinely releases any wage levies. The Wage Garnishment Law requires prompt notification and termination of the levy once the debt is satisfied (CCP §706.027). If a debt is uncollectible as a matter of law because it is withdrawn or not subject to collection for any reason, FTB routinely immediately releases its wage levies. This does not include amounts deemed uncollectible merely because the tax debtor and/or the debtor's assets cannot be located.

The Government Code (§16301.6) provides that a state agency may be discharged from collecting a debt if it is "uncollectible," because the tax debtor and/or the debtor's assets cannot be located. Pursuant to this authority, FTB discharges accounts from collectibility as warranted. Discharging an account does not relieve the debtor from paying the tax; the debt remains subject to collection actions. For instance, if subsequent to discharging the account FTB receives employer information on the tax debtor, a levy is issued with respect to that discharged debt. When the debt is satisfied, the discharge is reversed, and any levies are routinely released.

This provision would codify current practice and generally conform to the federal provision. However, it expressly would not apply to discharged accounts, in which case, levies on salaries or wages would not be released until satisfied.

Policy Considerations

- Under federal law, a tax is most likely uncollectible by the IRS because the 10-year SOL for collection has expired. California does not have a collection SOL (conformity to the federal 10-year SOL for collections has been previously explored and may be considered in the future under a separate proposal) so to this extent conformity may not be appropriate. However, there are other instances where taxes may be "uncollectible" (e.g., the assessment is withdrawn or abated) and for which FTB should be required to continue its current practice of immediately releasing wage levies.

Implementation

This provision basically would codify current practice as to the manual collection process.

FISCAL IMPACT

Departmental Costs

This provision would not significantly impact the department's costs.

Tax Revenue Estimate

This provision would not impact state tax revenue.

21. Approval of Jeopardy/Termination Assessments

SUMMARY

This provision (§19084) would require FTB's Chief Counsel (or delegate) to personally approve (in writing) the issuance of jeopardy assessments, termination assessments or levies thereon.

EFFECTIVE DATE

This provision would be operative for taxes assessed and levies made after the effective date of the bill.

SPECIFIC FINDINGS

The IRS Reform Act requires the IRS Chief Counsel (or delegate) to approve a jeopardy assessment or termination assessment with immediate levy on those assessments.

Currently under state law, a levy is issued simultaneously with the jeopardy or termination assessment (JAs), since the basis for these assessments is that collection is in jeopardy. The issuance of these JAs are approved by section managers, supervisors or staff serving in a lead capacity, depending upon the source of the assessment information. The assessments may be issued in field offices or satellite offices, whereas the Chief Counsel is located in FTB's central office. Typically, JAs result from illegal activity but may result for business transfers or sales. On an average, fewer than ten JAs are issued by FTB annually.

This provision would conform to the federal provisions relating to approval of JAs.

Implementation

This provision should be implemented without significant problems assuming the approval process would be expedited to prevent delays in issuing JAs and levies.

FISCAL IMPACT

Departmental Costs

This provision should not impact the department's costs. Workload increases would be experienced to the extent there is additional time spent for the review required by this provision.

Tax Revenue Estimate

Revenue losses from this provision would be negligible, if any, based on the negligible revenue impact projected for the federal law change and assuming the approval process would be expedited to avoid delaying the issuance of JA and levies.

22. Waiver of Early-Withdrawal Penalties

SUMMARY

This provision (§17085.7) would provide an exception to the 2½% early withdrawal penalty for qualified retirement plans or Individual Retirement Accounts (IRAs) subject to levy by FTB.

EFFECTIVE DATE

This provision would apply to distributions made after December 31, 1999. This provision would become operative at the same time as the federal provision since implementation would not require program changes.

SPECIFIC FINDINGS

Generally under federal law, the IRS is authorized to levy upon all non-exempt property or rights to property belonging to the taxpayer. Qualified retirement plans and IRAs are not exempt from levy by the IRS. Moreover, distributions from a qualified plan or IRA are includable in the taxpayer's gross income to the extent that the distribution represents pre-tax contributions or earnings on investments regardless of whether the plan or IRA is subject to levy. Further, the amount of the distribution included in the gross income of a taxpayer is subject to a 10% early withdrawal penalty unless the distribution is made after the taxpayer reaches age 59½ or one of several other specifically enumerated exceptions applies. **Prior to the IRS Reform Act**, distributions made on account of an IRS levy were not listed as an exception to the early withdrawal penalty; thus, such distributions were subject to the penalty unless the distribution met one of the other exceptions.

The IRS Reform Act provides an exception to the 10% early withdrawal penalty for amounts withdrawn from an employer-sponsored retirement plan or IRA that are subject to a levy by the IRS. This provision only applies if the plan is levied. It does not apply when the IRS has not levied upon the taxpayer and the taxpayer withdraws funds to pay taxes in order to avoid a levy, to obtain the release of a levy on other interests, or in any other situation not specifically addressed by the statutory exceptions.

California law is generally the same as federal law prior to the IRS Reform Act. FTB is authorized to levy upon all non-exempt property or rights to property belonging to the taxpayer, including qualified retirement plans and IRAs. Distributions from a qualified plan or IRA levied by the FTB are includable in the taxpayer's gross income to the extent that the distribution represents pre-tax contributions or earnings on investments and are subject to a 2½% early withdrawal penalty unless one of the specified exceptions applies.

This provision would provide an exception to the 2½% early withdrawal penalty for qualified retirement plans and IRAs subject to levy by FTB. This provision only applies if the plan is levied.

Implementation

Implementation of this provision would occur during the department's normal annual system update.

FISCAL IMPACT

Departmental Costs

This provision would not significantly impact the department's costs.

Tax Revenue Estimate

Revenue losses from the exception to the 2.5% early withdrawal penalty would result in negligible revenue losses, if any.

23. Procedures for Seizure of Property

SUMMARY

Under this provision (§19236), before issuing a warrant to seize or sell property FTB would be required to investigate the status of the property subject to levy as prescribed.

EFFECTIVE DATE

This provision would be operative for warrants issued on or after the effective date of this bill.

SPECIFIC FINDINGS

The IRS Reform Act basically codified IRS administrative practice. Before IRS levies on property to be sold, an investigation of the status must be made which will include:

- Verification of the taxpayer’s liability;
- Completion of an analysis to determine whether the expenses of the levy and sale would exceed the fair market value of the property at time of levy;
- Determine whether the equity in the property is sufficient to yield net proceeds from the sale to apply to the tax debt; and
- A thorough consideration of alternative collection methods.

Under current practice, FTB basically follows the same valuation process as above in determining whether to issue a warrant to seize and sell property of a tax debtor to collect delinquent taxes.

This provision would conform to the federal provision relating to procedures for seizure of property by codifying FTB’s current practice.

Implementation

This provision would codify current practice.

FISCAL IMPACT

Departmental Costs

This provision would not impact the department’s costs.

Tax Revenue Estimate

This provision would not impact state revenues.

24. Procedures for Seizure of Residences or Businesses

SUMMARY

Under this provision (§19236(b) and (c)), FTB generally would be prohibited from selling principal residences for liabilities of $5,000 or less and would be required to obtain assistant executive officer (or delegate) approval before levying on a taxpayer's tangible personal property or real property (other than rented real property) used in a trade or business.

EFFECTIVE DATE

This provision would be operative on effective date of the bill.

SPECIFIC FINDINGS

The IRS Reform Act:
- prohibits IRS from seizing any real property used as a residence by the taxpayer or any non-rental real property of the taxpayer used by any other individual as a residence to satisfy liabilities of $5,000 or less (including penalties and interest).
- requires approval of district or assistant district director before IRS can seize a taxpayer's tangible personal property or real property (other than rented real property) used in a trade or business. The Act also requires IRS to exhaust all other collection options before seizing these properties.
- allows a levy on a principal residence as defined by IRC only if a judge or magistrate of a U.S. district court approves the levy (in writing).

FTB's current practice generally prohibits the seizure and sale of principal residences and dwellings in general if the tax debt is $5,000 or less. Under the CCP, to which FTB must comply, a sale of any dwelling requires a court order (CCP §704.740). Seizures and sales of most property require pre-approval by a collection supervisor. FTB's current practice also dictates that all collection options be exhausted before real property or business property is seized and sold.

This provision would generally conform to the federal provision and basically codify FTB's current practice, except the sale of any dwelling, not only the principal residence of the tax debtor, would continue to require a court order as provided under the CCP. Additionally, the assistant executive officer for collections is designated as the person, unless he or she delegates to another, responsible for approving warrants for levying on trade or business property.

Implementation

This provision would not significantly impact FTB's programs or operations as it basically codifies current practice. However, a minor workload increase could be experienced by the Legal Branch due to questions and advice, discussion and review with respect to the various facts of a particular case.

FISCAL IMPACT

Departmental Costs

This provision would not impact the department's costs.

Tax Revenue Estimate

It is anticipated that this provision would not impact state revenues.

25. Extension of SOL

SUMMARY

This provision (§19067) would require FTB to inform taxpayers of their right to refuse to extend the SOL or the right to limit the extension to a particular period of time.

EFFECTIVE DATE

This provision would apply to SOL waivers requested after December 31, 2000.

SPECIFIC FINDINGS

Under federal law, the IRS generally has three years from the due date of a return to assess additional tax. The IRS and a taxpayer may agree to an extension of time to assess taxes. To obtain an extension, the parties must execute a written consent before the initial period of assessment expires.

The IRS Reform Act requires the IRS to notify taxpayers of their right to (1) refuse to extend the SOL for assessments or (2) limit the extension to particular issues or to a particular period of time. The notice must be provided each time an extension is requested.

Under current state law, FTB generally has four years from the due date of a return to assess additional tax. FTB and a taxpayer may agree to an extension of time to assess taxes. To obtain an extension, the parties must execute a written consent before the initial period of assessment expires.

Under current state policy (Audit Branch Policy Statement 98-2) waivers modified by taxpayers are not accepted by the department except in limited circumstances. This policy was enacted because of arguments between taxpayers and the department regarding modified waivers. Taxpayers were claiming that under contract law the waivers were invalidated because the modifications were considered counter-offers that were not accepted by the department.

This provision would require FTB to inform taxpayers of their right to (1) refuse to extend the SOL for assessments or (2) limit the extension to a particular period of time. The notice must be provided each time an extension is requested.

Policy Considerations

Current federal and state procedures are different regarding when waivers to limit the extension of the SOL to particular issues are accepted. The department generally asks for a waiver during an examination (they may even be requested before the audit has started), while the IRS generally asks for a waiver during the appeals process (after the examination). Allowing waivers to be limited to particular issues could limit the scope of an examination. Thus, this provision would not conform to the federal provision requiring the IRS to notify taxpayers of their right to limit waivers to particular issues.

Implementation

Implementation of this provision would occur during the department's normal annual system update.

FISCAL IMPACT

Departmental Costs

This bill would not significantly impact the department's costs.

Tax Revenue Estimate

This provision would not impact state revenues.

26. Installment Agreements

SUMMARY

Under this provision (§19008), upon request from the tax debtor, a rejected offer of an installment agreement (OIA) would be subject to an independent departmental review, for which the Taxpayers' Rights Advocate would establish procedures. During the period the OIA is pending approval or being reviewed, no levy may be issued by FTB.

EFFECTIVE DATE

This provision would be operative for proposed installment agreements submitted after December 31, 2000.

SPECIFIC FINDINGS

Under the **IRS Reform Act**, IRS is:
- prohibited from levying (1) during any period that an offer of an installment agreement (OIA) is pending, (2) during 30 days after rejection of the OIA, (3) during appeal of rejection of an OIA, or (4) during the period an installment agreement is in effect or 30 days after termination of installment agreement.
- required to implement procedures for administrative review of all rejections of OIAs prior to notifying the taxpayer of rejection and for taxpayers to appeal rejections to the IRS Office of Appeals.

Under current state law, in the event of a financial hardship, tax debtors may offer to enter into an installment agreement (OIA) with the FTB to pay their taxes over an extended period. During that agreed upon period, collection actions are held in abeyance. In addition, there are informal payment arrangements during the initial billing cycle, before collection actions are imminent, which allow tax debtors to pay off their tax debt over a several-month period to avoid collection actions.

Under **FTB's** current practice:

- during the time an OIA is pending, levies may be stayed; and
- rejections of OIAs are not subject to review, even upon request by the tax debtor. However, under current law, installment agreements rendered null and void or otherwise terminated are subject upon taxpayer request to independent review, under procedures established by the Taxpayers' Rights Advocate.

Under current state law, many administrative hearings must be conducted by administrative law judges through formal proceedings, requiring strict rules of evidence (Administrative Procedures Act [APA]). Expressly excepted from the APA are FTB's protest hearings and hearings regarding jeopardy assessments. Additionally, FTB's informal hearings relating to collection activities have not been subject to the APA.

This provision would generally conform to the federal provisions relating to OIAs. This provision is not intended to apply to informal payment arrangements. Additionally:

- The prohibition on levies expressly would apply to initial OIA and related appeals only. At the discretion of the FTB, the prohibition could apply to offers made after the rejection/appeal of the initial OIA.
- All OIAs would not be routinely reviewed. A review would be conducted only upon taxpayer request. The Taxpayers' Rights Advocate would establish procedures for requested independent departmental administrative review of rejected OIAs. The review process expressly would not be subject to the APA.

Policy Considerations

- Tax debtors submitting an OIA should be entitled to statutory protection and security against collection actions. Unless California conforms to this federal provision, tax debtors submitting OIAs must rely on FTB continuing its current practice.

- The federal provision is silent as to whether IRS has recourse if tax debtors continually resubmit OIAs as a means for delaying collection. This provision makes it clear that subsequent offers will not stay collection except at the discretion of the FTB.

Implementation

- As to the prohibition on levies, this provision should not significantly impact FTB's programs or operations as it generally codifies current practice.

- As for the review process, implementation does not appear problematic for the department. The Taxpayers' Rights Advocate would need to establish procedures for the independent review process.

FISCAL IMPACT

Departmental Costs

This provision's impact on departmental costs is unknown but not expected to be significant. It is unknown the number of tax debtors who may request review if their OIAs are rejected, and the resulting workload.

Tax Revenue Estimate

Revenue impacts associated with this provision would be negligible, if any.

27. Notice Include Deadlines

SUMMARY

This provision (§19034, §19041, §19045) would require FTB to provide the last date a taxpayer may protest or file an appeal on notices of proposed assessment (NPAs) or notices of action (NOAs). Protests or appeals filed by the date specified on the NPA or NOA would be considered timely.

EFFECTIVE DATE

This provision would apply to notices mailed on or after December 31, 1999.

SPECIFIC FINDINGS

Under federal law, taxpayers seeking a redetermination of tax liability before the Tax Court must file a Tax Court petition within 90 days after the deficiency notice is mailed (within 150 days if the person is outside the United States). If the taxpayer fails to file a petition within that time period, the Tax Court lacks jurisdiction to consider the petition.

The IRS Reform Act requires the IRS to include on each deficiency notice the date it determines to be the last day on which the taxpayer may file a petition with the Tax Court. A petition filed with the Tax Court by the date indicated on the deficiency notice is considered timely filed; thus, taxpayers may rely on the date provided by the IRS.

Under state law, a taxpayer may protest a NPA within 60 days after the mailing of the notice. If no protest is filed, the NPA is final after the end of the 60-day protest period. When FTB takes action on a protest, a NOA is mailed to the taxpayer. The taxpayer has 30 days after the mailing of the NOA to file an appeal with the BOE. If no appeal is filed, the NOA becomes final after the end of the 30-day appeal period.

This provision would require FTB to provide on the NPA or the NOA as appropriate, the last date a taxpayer may protest an assessment or file an appeal. Protests or appeals filed by the date indicated on the notice would be considered timely filed. Failure to include the date would not make the notice invalid.

Policy Considerations

Although the department includes an explanation of the timeframes in which to file a protest or appeal with the NPA or NOA as appropriate, taxpayers can make errors when determining the last date to file a protest or appeal. This provision would clearly state the last date to file a protest or appeal for the taxpayer and the department.

Implementation

Implementation of this provision would require taxpayer information (TI) and business entity taxpayer (BETS) systems changes to place the appropriate date on notices.

FISCAL IMPACT

Departmental Costs

The department's costs to administer this provision are preliminary. Department staff will continue to review this provision to determine the costs associated with implementation. A portion of the costs for TI and BETS system changes (discussed on page 3 of this analysis) would be attributable to this provision.

Tax Revenue Estimate

This provision would not impact state revenues.

28. Explanation of Refund Disallowance

SUMMARY

This provision (§19323) would require FTB to notify the taxpayer of the specific reasons for disallowing a refund claim.

EFFECTIVE DATE

This provision would apply to disallowances made after the 180th day after the effective date of the bill.

SPECIFIC FINDINGS

Under federal law, a taxpayer is required to file a claim for refund within three years after filing the return or within two years after paying the tax, whichever period expires later. The Examination Division of the IRS within 30 days must review claims for refund after receipt. A claim is initially evaluated to see whether it should be disallowed because:

- it was not timely filed,
- it is based solely on the alleged unconstitutionality of the Revenue Acts,
- there is evidence in the case file that the refund was waived as consideration for a settlement,

- it covers a tax period in which the tax liability or specific issues were the subject of a final closing agreement or in which the tax liability was compromised, or
- it relates to a return closed on the basis of a final court order.

If the claim can be denied for one of these reasons, the IRS issues a form letter stating that the claim cannot be considered. If the claim cannot be denied for one of these reasons, it is examined as soon as possible. If the claim is denied, the reasons for partial or total disallowance must be stated in the agent's report and sent to the taxpayer.

The IRS Reform Act requires the IRS to notify the taxpayer of the specific reasons for the disallowance, or partial disallowance, of refund claims.

Under state law, generally a claim for refund must be filed within four years from the due date of the return or one year from payment of the tax, whichever is later. If not filed within these periods, the claim is rejected as untimely. It is **FTB's practice** to inform the taxpayer of the reason for the disallowance.

This provision would require FTB to notify the taxpayer of the specific reasons for the disallowance, or partial disallowance, of refund claims.

Implementation

This provision would codify current practice.

FISCAL IMPACT

Departmental Costs

This provision would not impact department costs since it codifies current practice.

Tax Revenue Estimate

This provision would not impact state revenues.

29. Whistleblower Disclosure

SUMMARY

This provision (§19546.5) would allow any person who has or had access to return or return information to disclose that information to a California legislative committee if the whistleblower believes the information relates to evidence of possible misconduct or taxpayer abuse.

EFFECTIVE DATE

This provision would become operative on the effective date of the bill.

SPECIFIC FINDINGS

Under federal law, the IRS is required to disclose taxpayer return information to the Chair of the Senate Finance Committee, House Ways and Means Committee, or

Joint Committee on Taxation upon request from the Chair. Information that directly or indirectly identifies a particular taxpayer may only be furnished to a committee sitting in a closed session, unless the taxpayer consents in writing to making the information available in open committee meetings.

Prior federal law did not provide a way for IRS employees to reveal return information in the course of reporting misconduct or taxpayer abuse to a congressional committee. Thus, employees were prevented by the use of taxpayer confidentiality provisions from reporting suspected abuses.

The IRS Reform Act allows any person with current or prior authorized access to taxpayer return information to disclose the information in the course of reporting IRS employee misconduct or taxpayer abuse to the House Ways and Means Committee, the Senate Finance Committee, or the Joint Committee on Taxation. Disclosure is permissible if the person believes that the return information being disclosed may be related to possible misconduct, maladministration, or taxpayer abuse. Written approval from the committee chair is not required prior to disclosure.

Current state law allows for the disclosure of taxpayer information to a legislative committee upon the request of the committee. Disclosure rules then apply to the committee or any member or other employee. It is unclear whether current law would allow a “whistleblower” to provide information to a legislative committee.

This provision would allow employees or former employees to disclose information to California legislative committees if the whistleblower believes the information relates to evidence of possible board misconduct, maladministration or taxpayer abuse.

Implementation

Implementation of this provision would occur during the department’s normal annual system update.

FISCAL IMPACT

Departmental Costs

This provision would not impact the department’s costs.

Tax Revenue Estimate

This provision would not impact state revenues.

30. Identification of Return Preparer

SUMMARY

This provision (§18624) would allow tax preparers to use on the state return any identifying number the IRS prescribes as the identifying number of the return preparer.

EFFECTIVE DATE

This provision would be operative on the effective date of the bill.

SPECIFIC FINDINGS

Under federal law, tax return preparers must provide an identifying number on tax returns or claims of refund that they prepare. As with any person required to make a return, statement or other document, the identifying number of the return preparer is his or her social security number.

The IRS Reform Act authorizes the IRS to approve alternatives to social security numbers for use as identifying numbers by tax return preparers.

Current state law conforms to federal law requiring social security numbers as identification of individuals who prepare tax returns.

This provision would allow return preparers to use any identifying number the IRS prescribes as the identifying number of the income tax return preparer.

Implementation

Implementation of this provision would occur during the department's normal annual system update.

FISCAL IMPACT

Departmental Costs

This provision would not significantly impact the department's costs.

Tax Revenue Estimate

This provision would not impact state revenues.

.